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SUBJECT: MICROSOFT: CLOSE TO FINAL DEAL WITH EU TO END COMPETITION
CASES

¶1. (SBU) SUMMARY. John Vassallo, Microsoft (MS) VP for EU Affairs, told Charge Sept. 24 that the company "is very close" to concluding an overarching deal with the European Commission on three antitrust issues: 1) the Commission's case against Microsoft's tying of Internet Explorer to Windows; 2) a five-year deal on sharing interoperability information with rival firms; and 3) a 10-year agreement to support PDF and other file format compatibility with Microsoft's own file format. Vassallo said there are only a few small issues to resolve over the tying case, which will involve MS agreeing to provide within the EU all new Windows computer buyers, and all customers upgrading Windows versions, a "ballot screen" whereby customers can select from 12 internet browsers to use as their default browser. Customers would also be able to deactivate Internet Explorer completely. This element of the deal will require a four-week EU market test and formal approval by the College of Commissioners, which MS hopes for by October 28.

¶2. (SBU) Vassallo said the whole package represents a historic opportunity for the Commission and Microsoft to resolve past disputes and move into a new era of cooperative relations. Commissioner Neelie Kroes has been publicly advertising her interest in concluding the total deal (as part of her legacy before she leaves the Commission), increasing its likelihood of success. Charge asked if MS requested U.S. engagement; Vassallo said not directly, but stressed the value of emphasizing that reaching a deal would be good for all parties concerned. After an 11-year battle involving nearly \$2.5 billion in Commission fines against Microsoft, both sides of this epic competition battle may be ready to end confrontation and resolve their differences. END SUMMARY.

MICROSOFT SEES OVERALL AGREEMENT NEAR

¶3. (SBU) John Vassallo, Microsoft (MS) VP for EU Affairs, told Charge d'Affaires and Acting EconCouns September 24 that press statements by Competition Commissioner Neelie Kroes and Director General Philip Lowe, in the U.S. for conferences, that an overall Commission-Microsoft deal is close are correct. He explained that Microsoft and the Commission have been in intensive negotiations since July that have brought the two parties close to an overarching package agreement on three outstanding antitrust issues (one formal and two informal).

THREE ELEMENTS OF PACKAGE DEAL

¶I. FORMAL AGREEMENT ON REMEDIES FOR IE-WINDOWS TYING CASE

¶4. (SBU) The major element of the proposed deal, Vassallo said, is Microsoft's proposed remedy for the Commission antitrust case against MS tying of Internet Explorer to its Windows operating system. Vassallo briefly recounted the history of the Commission case against MS for tying Media Player to Windows, which resulted in a 2004 Commission decision and massive (497 million euro) fine against Microsoft, which was upheld in 2007 by the EU Court of First Instance. The remedy required by the Commission, that of MS offering a version of Windows without Media Player, failed to resolve concerns since it was commercially unsuccessful.

¶5. (SBU) In 2006, Vassallo said, Opera, a small Norwegian browser company, filed a similar antitrust complaint over MS tying of IE to Windows. The Commission took up the case, and MS began negotiations with the Commission over a solution. In December, 2008, the two sides were close to informal agreement, Vassallo said, but the Commission stuck to its desire to have computer makers (OEMs) include all major browsers in software bundles for new computers, with customers able to choose one as a default browser.

¶6. (SBU) This agreement was not acceptable to MS, and the Commission filed a formal antitrust charge (Statement of Objections) in January 2009. The Commission then offered a hearing date that MS could not take due to scheduling conflicts, Vassallo said. Faced with an enormous potential Commission fine (2-6 billion euros, retroactive to 1996), MS began new informal negotiations with the Commission towards a solution.

¶7. (SBU) In July MS and the Commission came to initial agreement on a remedy that would resolve the complaint. MS agreed to direct all new computer buyers within the EU, upon their first connection to the Internet, to a "ballot screen" that would allow them to download any of 12 competing browsers, make it their default browser, and deactivate IE if desired. This would only be true for OEMs who include IE as the initial default browser; if OEMs reach a better financial deal with another browser maker (e.g. Google) to make that browser the default, the customer would not get the ballot screen option. Vassallo added that existing Windows computer users would get the same ballot screen and IE deactivation option when upgrading their version of Windows.

¶8. (SBU) This formal agreement to resolve the tying case is subject to approval by the College of Commissioners, Vassallo continued, which is only possible after a four-week mandatory market test of the proposed remedy. MS hopes to begin this test extremely soon, he said, to allow time for formal Commission approval by October 28.

¶9. (SBU) Vassallo said there are a few very minor issues to resolve over this part of the deal, including such points as: required security awareness messages for ballot screen users, the order in which browser options might be displayed, and the size of different logos. He hoped to resolve these within days and thought none are likely to upset a final deal.

¶10. (SBU) Vassallo clarified that MS will launch Windows 7 in Europe on October 22, in advance of likely final approval of the agreement. This would not include a ballot screen option, but if a deal is in fact concluded within the following weeks, MS would link Windows 7 computers automatically back to the ballot screen webpage, so the launch timing should not disrupt conclusion of a deal.

II. INFORMAL AGREEMENT ON INTEROPERABILITY

¶11. (SBU) Vassallo said that a second part of the deal would resolve a Commission investigation, based on a complaint by anti-MS lobby group ECIS (which counts Sun, IBM and other U.S. and EU firms as members) of MS alleged failure to share adequate code or information on understanding MS code to allow MS competitors to develop and run products that would work properly with MS operating systems and other software. This agreement will involve MS offering licenses on certain code for a nominal fee, posting 75,000 pages on its code on the web and establishing labs where competitors' software developers can come for instruction on how to develop products to work with MS code. There will also be a rapid arbitration procedure for disputes, Vassallo added, and MS will agree to pay 135,000 euros/day to operators who cannot get their system to work with MS products

after recourse to the above.

III. INFORMAL AGREEMENT ON PDF AND OTHER FILE SUPPORT

¶12. (SBU) The third and final part of the package is an agreement under which MS will be obliged to support for 10 years compatibility of Adobe PDF files and other similar document files with Microsoft's Open XML proprietary format. The support will be backwards-compatible, allowing billions of documents in older formats to be accessible. Vassallo noted here the Commission's positive July statement on MS efforts to promote interoperability, which he said was without precedent.

¶13. (SBU) Both informal agreements will only come into effect once the formal agreement is concluded, Vassallo added.

MICROSOFT: DEAL REPRESENTS "HISTORIC OPPORTUNITY" FOR COMMISSION

¶14. (SBU) Vassallo underscored that the whole package represents a historic opportunity for the Commission and Microsoft to resolve past disputes and move into a new era of cooperative relations. If the small pending issues for the formal agreement on tying are resolved quickly, the Commission can move to the market test. Vassallo said that MS had seen a remarkable turnaround in the willingness of the Commission to deal directly and openly with Microsoft, which he attributed to Commissioner Kroes' strong, publicly-stated interest in resolving the Microsoft cases as part of her legacy before she leaves the Commission in the next few months.

¶15. (SBU) Vassallo said his only major fear was that the Commission might use the results of the ballot screen market test to come back to MS and ask for more concessions/changes before final Commission approval. This could scotch a final deal. If the deal falls apart, the Commission would face the choice of proceeding with a fine and forced remedy, which Microsoft would challenge in court. Vassallo said he understood that Kroes and DOJ AAG Varney have been in close touch on the overall deal.

¶16. (SBU) The Charge asked about MS outreach to USG officials in Washington; Vassallo noted that Microsoft has briefed DOJ on the impending settlement. Charge then asked if MS is requesting direct USEU engagement; Vassallo said no, but , but added that if senior USEU or visiting USG officials happen to meet with relevant EU decisionmakers, they could stress the value of reaching a deal for all parties concerned. The proposed deal is good for the EU, the market and consumers, Vassallo concluded.

COMMENT

¶17. (SBU) Vassallo's story reflects Microsoft's point of view, and it is unclear how the Commission sees prospects and potential obstacles involved in an overarching package deal on Microsoft's competition cases. Microsoft does have other potential issues in Europe, with the possibility of a Commission review of its advertising alliance with Yahoo, and with browser competition with Google turning increasingly nasty. Nevertheless, after an 11-year battle involving nearly \$2.5 billion in Commission fines against Microsoft, both sides of this epic competition policy battle may be ready to end confrontation and resolve their differences, for now.

END COMMENT.

MURRAY